

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Kaloogian Analyst: Marion Mann DeJong Bill Number: AB 1428
Related Bills: See Legislative History Telephone: 845-6979 Amended Date: 04/22/1999
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Allow Cash Bond Payments & Preserve Taxpayers' Right To Refund Action

SUMMARY OF BILL

This bill would allow taxpayers to make a deposit in the nature of a "cash bond" to stop the running of interest and still preserve the taxpayer's right to file a claim for refund at a later time. The Franchise Tax Board (FTB) would be prohibited from collecting any amount that is disputed in the action while the action is pending.

This bill also would modify the law relating to documentary transfer taxes imposed when property is transferred. This provision is not discussed in this analysis because it does not impact the programs administered by FTB.

SUMMARY OF AMENDMENT

The April 22, 1999, amendments added the provision regarding cash bonds to the bill as introduced. Prior to this amendment, the bill did not impact the programs administered by FTB.

EFFECTIVE DATE

This bill would become effective January 1, 2000, and would apply to payments made on or after that date.

LEGISLATIVE HISTORY

AB 1469 (1998) contained a provision almost identical to the cash bond provision of this bill. The Governor vetoed AB 1469 for an item unrelated to cash bonds. AB 41 (1999), as introduced, was almost identical to the cash bond provision of this bill. AB 41 was amended to allow the posting of a cash bond to stop the running of interest and still preserve the taxpayer's right to raise new grounds disputing the validity of an assessment. AB 1392 (1999), a similar bill, would allow a taxpayer to bring an action to determine the validity of a tax by posting a bond to guarantee payment of the amount due.

SPECIFIC FINDINGS

Current federal and California laws provide for the payment of interest on overpayments of tax. Cash bonds and "voluntary payments" are not overpayments of tax; thus, interest is not paid when these amounts are refunded to the taxpayer.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald Goldberg

5/11/1999

Current federal law allows a taxpayer to file a petition with the Tax Court for a redetermination of a deficiency within 90 days (150 days if addressed to persons outside the United States) after the notice of deficiency is mailed. No assessment of a deficiency may be made until after the expiration of the 90-day period, or if petition is filed, until the decision of the Tax Court is final.

Current federal procedures (Rev. Proc. 84-58) allow a deposit in the nature of a cash bond while a deficiency is pending in administrative proceedings or Tax Court. The bond amount may be refunded without interest at any time, and if the taxpayer prevails in administrative proceedings, the entire bond may be refunded to the taxpayer without interest. This is an important strategic tool for taxpayers because a taxpayer can make a payment in the nature of a cash bond to stop the accrual of interest while preserving the jurisdiction of the Tax Court to review the underlying deficiency. A Tax Court decision can be appealed all the way to the Supreme Court without paying the deficiency. However, collection of amounts affirmed by the Tax Court is not stayed during appellate review when a bond is posted with the court.

Under federal law and procedures, if during the administrative review or appeals process a taxpayer pays the deficiency rather than posting a cash bond, no notice of deficiency is issued and taxpayers are precluded from challenging the deficiency assessment in Tax Court. The taxpayer must start over from the beginning with a refund claim that is treated as a new case. The taxpayer must then appeal any IRS action on the new refund claim to an U.S. district court or the U.S. Claims Court rather than the Tax Court.

Under California law, unlike the federal system, an unpaid deficiency cannot generally be appealed to a court (except in the limited case of a determination of residency, wherein a taxpayer may file suit in specified superior courts in this state without payment of the proposed assessment of additional tax). In addition, the protest of a proposed deficiency or the appeal of FTB's denial of a taxpayer's protest may be converted to a claim for refund upon payment of the underlying deficiency, without the necessity of starting a new administrative process. Once the tax is paid, taxpayers have one year from the date of payment to assert all bases for their dispute.

The California Constitution (Article XIII, Section 32) requires that all tax for a given "period"¹ must be paid prior to going to court on a claim for refund.

Current department practice with respect to payments of tax made during an audit is to treat them as payments for the year in question and to show them as payments reducing the balance due when a proposed deficiency assessment is finally issued. If the payments exceed the proposed assessment amount, the excess is refunded with interest.

If a taxpayer wants to post a "cash bond" rather than make a payment of tax, **current department procedures** treat such payments as "voluntary payments" that do not earn interest. However, this is an unusual occurrence because it is beneficial to the taxpayer to have the payment designated as a payment of tax, so

¹ The California Supreme Court is currently considering whether interest as well as tax must be paid in the case of *Agnew v. SBE*.

that interest can be paid on the overpayment in the event the taxpayer is successful.

This bill would allow a taxpayer to make payment of taxes by making a deposit in the nature of a cash bond to stop the running of interest and preserve the taxpayer's right to file a claim for refund. However, no interest would be paid if the taxpayer is successful and the cash bond is returned to the taxpayer. FTB would be prohibited from collecting any amount that is disputed in the action while the action is pending.

Policy Considerations

This provision would raise the following policy considerations.

- Under the federal system a deficiency can be challenged in the Tax Court, and claims for refunds are heard in a U.S. district court or the U.S. Claims Court. The cash bond procedure permits a taxpayer to preserve the existence of an unpaid deficiency to permit litigation in the Tax Court. Under the California system, only claims for refund can be litigated in court. Thus, the primary reason that taxpayers use the federal cash bond procedure does not exist for California tax disputes.
- This proposal may trap unwary taxpayers. Currently, taxpayers get a deduction on their federal return for taxes paid during the year. Posting a cash bond would not be considered payment for purposes of the federal deduction for state income taxes paid. Further, taxpayers that choose to post cash bonds rather than pay the proposed assessment under protest would earn no interest if successful and the bond is returned.
- Allowing taxpayers to post cash bonds could slow the protest and appeal process. This would occur because taxpayers could get two chances for department staff to review protests. For example, the taxpayer could post a cash bond and protest the proposed deficiency assessment. Department staff would review the protest, and in the event of an adverse finding, the taxpayer could request the tax bond be returned, pay the assessment and file a claim for refund starting the process over again. The taxpayer would then be able to present new issues as the basis of their dispute.

Constitutional Considerations

It is unclear what the effect would be if the cash bond is less than the full deficiency amount. Under the constitutional prohibition against prepayment court actions, well-established law is that no court action may be maintained until the full amount for the year is paid in full. Department staff is available to assist the author with any necessary amendments.

Technical Considerations

This bill would raise the following technical considerations. Department staff is available to assist the author with any necessary amendments.

- It is unclear whether this bill would allow the taxpayer to post a cash bond for an amount less than the full deficiency amount.
- This bill would require the Franchise Tax Board (FTB) to promulgate rules and regulations to adopt provisions of federal Revenue Procedure 84-58 (1984-2 C.B. 501). Revenue Procedure 84-58 contains rules and procedures relating to items other than payments in the form of cash bonds to stop the accrual of interest. It is unclear whether this bill would require the adoption of rules relating to the other issues in Revenue Procedure 84-58. Further, the language appears to be unnecessary since the Franchise Tax Board already has authority to promulgate any regulations necessary to administer the Revenue and Taxation Code. Department staff recommends deleting subdivision (b) from the bill.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

This bill would not impact PIT or B&CT revenues. It is not possible to project in advance the response of taxpayers to the posting of cash bonds for their deficiency assessments.

BOARD POSITION

Pending.